Levy Economics Institute of Bard College

January 25, 2016

One–Pager | No.52

A Complementary Currency and Direct Job Creation Hold the Key to Greek Recovery

DIMITRI B. PAPADIMITRIOU, MICHALIS NIKIFOROS, and GENNARO ZEZZA

Even under optimistic assumptions, the policy status quo being enforced in Greece cannot be relied upon to help recover lost incomes and employment within any reasonable time frame. And while a widely discussed public investment program funded by European institutions would help, a more innovative, better-targeted solution is required to address Greece's protracted unemployment crisis.

We used a stock-flow consistent macroeconomic model tailored to the Greek economy to project the outcome of adhering to current policy over the next three years—a status quo that requires the Greek government to impose further spending cuts and tax increases in accordance with the third Memorandum of Understanding. This baseline simulation shows GDP growth returning in 2017 after the mandated budget austerity has run its course. Notably, the return to growth in this scenario (1.8 percent in 2017 and 2 percent in 2018) is driven mainly by an increase in exports of goods and services. However, given that the price elasticity of Greek trade is relatively low, only a marginal part of the projected export growth is due to increased price competitiveness; that is, to the massive drop in labor costs since 2010 (a major problem for the official theory of how austerity is supposed to aid the Greek economy). The bulk of the improvement in Greek exports is attributable instead to relying in our baseline assumptions on the International Monetary Fund's (IMF) rosy predictions for the fortunes of Greece's trading partners. So it is revealing that *even if* this optimistic baseline projection bears out, the expected GDP growth rate would not be high enough to raise real income back to its 2006 level for the next *15 years*. And if the IMF is wrong about how fast Greece's trading partners grow, full recovery would be pushed even further beyond the horizon.

A change in policy is essential to restoring business confidence and healing Greece's deep socioeconomic wounds in a timely manner. Yet some of the more commonly touted policy alternatives are inadequate to the task. We estimated the effects of implementing a public investment program financed by outside (European) funds (€1 billion in 2016, €2 billion in 2017, and €3 billion in 2018). This "Juncker Plan," while superior to the status quo, is underpowered and poorly targeted. Though the rate of GDP growth would approach 3 percent in 2017 and 2018, due to our estimates of the lag between output increases and employment growth the number of jobs created would not have a significant effect on the unemployment rate.

The nature and scale of Greece's jobless crisis call for a solution aimed directly at the problem. For our third simulation, we modeled the effects of a public job creation program, an "employer of last resort" (ELR) plan offering paid work in public projects, financed by issuing a nonconvertible "fiscal currency": the Geuro. Implementation of a 550,000–job ELR program offering paid employment at 586 euros per month (which would provide a decent standard of living while avoiding competition with private sector employment) would require an annual expenditure of 7.5 billion euros. In our proposal, half of this would be paid in Geuros and the other half in euros, and the resulting increase in euro expenditure (3.75 billion annually) would be more than offset by paying 7.8 billion euros' worth of public sector wages, pensions, and other social benefits in Geuros instead (a 4 billion net decrease in annual euro payments). To support demand for the complementary currency, up to 20 percent of annual tax payments could be made in Geuros.

In this Geuro-funded ELR scenario, GDP growth in 2017 and 2018 would reach 4.1 percent and 3.8 percent, respectively. But more significantly, Levy Institute research indicates that a program of this size could cut the number of unemployed by more than half—a result of the targeted nature of the policy, which aims at employment creation with growth as a "side effect," rather than vice versa. As incomes rise due to the direct and indirect increase in employment, aggregate tax revenues would also grow. Greece's primary budget surplus targets would not be in jeopardy, nor would the plan adversely affect the country's external balance.

The Geuro is not designed to replace the euro and should not endanger Greece's membership in the eurozone. An apt comparison would be the Swiss WIR, which has been circulating alongside the Swiss franc since 1934, when it was introduced to address both liquidity and economic growth following the Great Depression. If Greece is going to recover within the confines of the euro, it must look beyond the status quo and the prevailing alternatives. Pinning the country's hopes on poorly targeted half measures, or on waiting for different results from the same policies, risks letting this humanitarian crisis continue to fester for a decade and beyond.

A more detailed discussion of the issues can be found at www.levyinstitute.org/publications/how-long-before-growth-and-employment-are-restored-in-greece.

DIMITRI B. PAPADIMITRIOU is president of the Levy Institute. MICHALIS NIKIFOROS and GENNARO ZEZZA are research scholars at the Institute.